

Private Letter Ruling: Partnership may subtract the portion of its income distributable to a charitable remainder unitrust.

June 13, 2005

Dear:

This is in response to your letter dated March 24, 2005, in which you request a Private Letter Ruling on behalf of PARTNERSHIP. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of 2 Ill. Adm. Code 1200.110 appears to be contained in your request. The Private Letter Ruling will bind the Department only with respect to PARTNERSHIP for the issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that PARTNERSHIP and/or any related taxpayer(s) is not currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows [footnote omitted]:

The purpose of this letter is to request a private letter ruling from the Illinois Department of Revenue in accordance with 2 Ill. Adm. Code § 1200.110 on behalf of PARTNERSHIP ("Taxpayer"). Taxpayer is a partnership seeking a ruling that, for purposes of computing its income subject to the Personal Property Tax Replacement Income Tax, it will be allowed a deduction for amounts of income distributable to charitable remainder unitrusts.

BACKGROUND

UNIVERSITY ("University"), located in CITY, Illinois, serves as trustee of a number of charitable remainder unitrusts (each a "Trust," and collectively, the "Trusts"), as defined in section 664(d)(2) of the Internal Revenue Code of 1986, as amended (the "Code"). Each Trust has been established pursuant to a separate trust agreement. In accordance with section 664 of the Code, each Trust makes a payment each year to one or more income beneficiaries. The payment is determined based on a fixed percentage of the Trust's assets, as revalued each year. At the death of the income beneficiary or beneficiaries, the assets of each Trust will be distributed to University. A charitable remainder unitrust is exempt from federal income tax under Code section 664(c), except to the extent, if any, of its unrelated business taxable income ("UBTI") for the year within the meaning of Code section 512. It is not expected that any of the Trusts will have UBTI.

For purposes of permitting University, as trustee, to pool the Trusts' assets for investment purposes and to better control income distributions made by the Trusts to the income beneficiaries, University has caused two general partnerships (one of which is the Taxpayer) to be formed under the Uniform Partnership Act (1997) of the State of Illinois, 805 ILCS 206/100 *et seq.* (each, a "Partnership," collectively the "Partnerships"). The partners in each Partnership will be limited to the Trusts. Certain of the Trusts will invest in both Partnerships (or will invest more or less of their assets than other Trusts in one or both Partnerships) to permit different asset allocations among the Trusts. Cash distributions from the Partnerships will be made to separate cash accounts established for each Trust, part or all of which will then be distributed to the income beneficiary or beneficiaries of the Trust.

RULING REQUESTED

Taxpayer respectfully requests that the Department rule that the Taxpayer, pursuant to section 203(d)(2)(I) of the Illinois Income Tax Act (the "IITA," 35 ILCS 5/101, *et seq.*), will, in computing its net income subject to the Personal Property Tax Replacement Income Tax (the "Replacement Tax," 35 ILCS 5/201(c) and (d)), be allowed to subtract from its base income amounts distributable to the Trusts.

DISCUSSION

Overview of the Replacement Tax

The Replacement Tax is imposed on a partnership at the rate of 1.5% of the partnership's net income. IITA 35 ILCS 5/201(c) and (d). "Net income" is defined as the taxpayer's "base income" allocated or apportioned to Illinois. 35 ILCS 5/202. A partnership's "base income" is its federal taxable income, subject to certain enumerated modifications. 35 ILCS 5/203(d)(1) and (e). A partnership may claim as a subtraction modification—*i.e.*, deduct from its base income—

An amount equal to all amounts of income distributable to an entity subject to the Personal Property Tax Replacement Income Tax imposed by subsections (c) and (d) of Section 201 of this Act including amounts distributable to organizations exempt from federal income tax by reason of Section 501(a) of the Internal Revenue Code." (35 ILCS 5/203(d)(2)(I).)

A trust's "base income" is its federal taxable income, subject to certain enumerated modifications. 35 ILCS 5/203(c)(1) and (e). Because, under Code section 664(c), the Trusts have no federal taxable income, the Trusts have no liability for Illinois income tax or Replacement Tax.

The Department's Interpretation

Of IITA section 203(d)(2)(I)

The Illinois Department of Revenue (the "Department") has consistently ruled that a partnership is eligible for the subtraction modification afforded by IITA section 203(d)(2)(1) for income distributable to an entity that is exempt from tax, even if exempt by reason of a provision other than section 501(a) of the Code, provided that the exemption is not an express exemption from the Replacement Tax under the IITA.

In PLR IT 97-0014 (June 26, 1997) and GIL IT 94-0075 (June 30, 1994), the Department addressed whether partnerships deemed created because of the pooling of the investment assets of nuclear decommissioning trusts could, in computing their Replacement Tax liabilities, subtract from base income amounts distributable to the decommissioning trusts. The trusts were not exempt from federal income tax under section 501(a) of the Code, but, under the Illinois Public Utilities Act, were exempt from all Illinois income taxation. 220 ILCS 5/8-508.1(f).

The Department ruled in PLR IT 97-0014 that "the term 'entity subject to the Personal Property Tax Replacement Income Tax' in Section 203(d)(2)(I) of the IITA must be construed to refer to all corporations, partnerships and trusts except those entities expressly exempted from Personal Property Tax Replacement Income Tax by an express provision of the IITA." The

Department thus concluded that the partnership could subtract the income distributable to the nuclear decommissioning trusts. The Department explained that, unlike the entities specifically exempted from the Replacement Tax pursuant to IITA section 205, “nuclear decommissioning trusts are subject to Personal Property Tax Replacement Income Tax under the express terms of the IITA.” The Department was unconcerned that the nuclear decommissioning trusts were not actually required to pay replacement tax:

The fact that this deduction will reduce a nuclear decommissioning trust’s Illinois taxable income to zero does not make the trust “exempt” from tax any more than any other entity could be considered “exempt” from tax because a deduction has eliminated its taxable income. To interpret the statute otherwise would cause absurd results.

Finally, the Department noted that the use of the word “includes” in IITA section 203(d)(2)(I) recognizes that the deduction is not limited to amounts distributable to Section 501(a) organizations. PLR IT 97-0014 at n.2. The Department reached the same conclusions in GIL IT 94-0075.

In PLR IT 91-0135 (May 30, 1991), the Department ruled that the amount of income distributable to an international organization for pension purposes may be allowed as a deduction from partnership income for purposes of the Replacement Tax, where it was possible that the international organization may have no Illinois tax liability. In support of this conclusion, the Department merely stated: “We do not deem it necessary at this time to determine whether this subtraction (deduction) arises pursuant to IITA § 203(d)(2)(G) as exempt income, or pursuant to IITA § 203(d)(2)(I) as income distributable to an entity subject to the replacement tax pursuant to IITA § 203(d)(2)(I).”

In PLR IT 91-0122 (May 7, 1991), the Department ruled that a partnership could subtract income distributable to state pension funds pursuant to section 203(d)(2)(I) of the IITA “because [the IITA] did not contemplate or intend to impose an income tax on income of any state of the United States. To disallow a subtraction in this instance would constitute an indirect tax which would not have been intended by the General Assembly.”

In PLR IT 89-0314 (Dec. 21, 1989), a partnership was also deemed entitled to a deduction for amounts distributable to a state government agency exempt from tax. The ruling noted that the subtraction modification of the IITA—

ensures that in a chain of partnership ownership, only the entity furthest up the ownership chain is liable for that tax. Moreover, where that uppermost entity is tax-exempt, the legislative scheme is clearly designed to allow that entity’s portion of the partnership chain income to be exempt from the Replacement Tax. The [IITA] does not attempt to impose the Replacement Tax on tax-exempt organizations merely for choosing to enter into otherwise tax-exempt investments through the use of a partnership.

See *also* PLR IT 87-0043 (Feb. 27, 1987) (holding, prior to the amendment of section 203(d)(2)(I), that amounts distributable by a partnership to organizations exempt from federal income tax by reason of section 501(a) of the Code may be subtracted in calculating the

Replacement Tax base of the partnership).

The Department's conclusions in the rulings discussed above are clearly correct. To reach a contrary result would contravene the intent of section 203(c)(1) of the IITA, which renders trusts subject to Illinois income tax to the extent they are subject to federal tax. Because the Trusts themselves would not be liable for any Replacement Tax on income from any assets they invested directly, the Trusts would effectively be taxed on income otherwise not taxable in Illinois if a subtraction modification for amounts distributable to the Trusts by the Partnerships were not allowed. See, e.g., GIL IT 94-0075. Such disallowance would constitute an indirect tax on the Trusts, violating the intent of the General Assembly to not tax charitable remainder trusts.

Application of Law

To the Partnerships

In accordance with the Department's principles and reasoning in its private letter rulings, a partnership is entitled to subtract from base income amounts distributable to an exempt entity provided that the entity is not "expressly exempted" from the Replacement Tax by an "express provision" of the IITA. While common trust funds described in section 584 of the Code and grantor trusts (under Code sections 671-678) are specifically exempt from Illinois income tax pursuant to section 205(e) of the IITA, no similar express exemption exists for charitable remainder trusts. Instead, charitable remainder trusts are "exempt" because they have no federal taxable income, and thus no base income (except to the extent, if any, of UBTI).

The Department has explicitly noted in a private letter ruling that "charitable remainder trusts are subject to Illinois income tax." PLR IT 93-0189 (Dec. 23, 1993). Thus, for example, a charitable remainder trust resident in the State of Illinois is required to file an Illinois income tax return if it is required to file a federal income tax return. See, e.g., GIL IT 94-0138-GIL (Dec. 8, 1994); PLR IT 93-0189; 35 ILCS 5/502(a)(2). Unless a charitable remainder trust has income taxable at the federal level due to unrelated business taxable income, it will have no base income to compute Illinois income tax liability. See GIL IT 95-0013 (Jan. 30, 1995); PLR IT 93-0160 (Oct. 26, 1993).

Although the Trusts will have no base income on which to compute their Illinois income tax (assuming they have no UBTI), the Trusts are not exempt from Illinois income tax pursuant to an express provision of the IITA. The Trusts are thus entities "subject to" the Replacement Tax, and the Partnerships may, under IITA section 203(d)(2)(I), subtract from their base incomes amounts distributable to the Trusts.

CONCLUSION

Taxpayer respectfully requests that the Department rule that it will be allowed a subtraction pursuant to section 203(d)(2)(I) of the IITA in computing its income subject to the Replacement Tax for amounts distributable to the Trusts.

REQUIRED STATEMENTS

1. The tax periods at issue are 2004 current and future periods.

2. No audit or litigation regarding this tax period or the issues presented is pending with the Department.
3. To the best of the knowledge of both the Taxpayer and the undersigned, (i) the Department has not previously ruled on the same or a similar issue of the taxpayer or a predecessor and (ii) neither the Taxpayer nor any representative has previously submitted the same or a similar issue to the Department and withdrawn it before a letter ruling was issued.
4. Favorable and contrary authorities have been discussed above.
5. A Power of Attorney will is enclosed.
6. A Deletions Statement is enclosed to the Department.

RULING

Sections 201(c) and (d) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/201) impose the Personal Property Tax Replacement Income Tax. Section 201(c) states as follows:

Beginning on July 1, 1979 and thereafter, in addition to such income tax [imposed by subsections (a) and (b) of Section 201], there is also hereby imposed the Personal Property Tax Replacement Income Tax measured by net income on every corporation (including subchapter S corporations), partnership and trust, for each taxable year ending after June 30, 1979. Such taxes are imposed on the privilege of earning or receiving income in or as a resident of this State. The Personal Property tax Replacement Income Tax shall be in addition to the income tax imposed by subsections (a) and (b) of this Section and in addition to all other occupation or privilege taxes imposed by this State or by any municipal corporation or political subdivision thereof.

A partnership's Illinois base income is its taxable income determined in accordance with Section 703 of the Internal Revenue Code (including separately stated items that would be taken into account by an individual in calculating taxable income), adjusted by certain statutorily prescribed addition and subtraction modifications. (IITA Section 203(e)(2)(H), 203(d)). IITA Section 203(d)(2)(I) provides partnerships a subtraction modification for income distributable to certain types of partners. Section 203(d)(2)(I) states:

An amount equal to all amounts of income distributable to an entity subject to the Personal Property Tax Replacement Income Tax imposed by subsections (c) and (d) of Section 201 of this Act including amounts distributable to organizations exempt from federal income tax by reason of Section 501(a) of the Internal Revenue Code.

A charitable remainder unitrust (CRUT) is defined in Section 664(d)(2) of the Internal Revenue Code as "a trust" that meets certain specified requirements. Accordingly, a CRUT is a trust for purposes of the IITA. (IITA Section 102, Department Regulations Section 100.9750(e)) Section 201(c) imposes the Personal Property Tax Replacement Income Tax on every trust within the taxing jurisdiction of

Illinois.¹ Therefore, every trust within the taxing jurisdiction of Illinois is subject to the Personal Property Tax Replacement Income Tax unless expressly exempt from such tax under another provision of the IITA. There is no provision in the IITA that expressly exempts a CRUT from the Personal Property Tax Replacement Income Tax. Section 201(c) is not rendered inapplicable merely because the measure of the tax is \$0.² Accordingly, the income of a partnership distributable to a CRUT qualifies for the subtraction modification under Section 203(d)(2)(I).

Applying the above to the instant case, the income of Taxpayer distributable to the Trusts qualifies for the subtraction modification under IITA Section 203(d)(2)(I).

The facts upon which this ruling is based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)

¹ Although Section 201(c) by its terms extends taxation to all trusts, other provisions of the IITA suggest that the phrase "subject to" a certain tax implies that the requisite jurisdictional requirements are met. See, for example, IITA Sections 205(f) and 303(f).

² Under Section 203(e)(1), the computation of a trust's Illinois base income begins with its taxable income properly reportable for federal income tax purposes. Therefore, if a CRUT has unrelated business taxable income, such income must be used to determine the CRUT's Illinois base income.